

hustling of these improper tax avoidance schemes is so commonplace that the representative of one major Texas-based multinational indicated that he gets a cold call every day from someone hawking such shelters.

As Stefan Tucker, former Chair of the American Bar Association Tax Section, a group comprised of 20,000 tax lawyers across the country, told the Senate Finance Committee: "[T]he concerns being voiced about corporate tax shelters are very real; these concerns are not hollow or misplaced, as some would assert. We deal with corporate and other major taxpayer clients every day who are bombarded, on a regular and continuous basis, with ideas or 'products' of questionable merit."

Two years later, we have this sequel from *Forbes* which raises the question, "How to cheat on your taxes?" It concludes that the marketing of push-the-edge and over-the-edge tax shelters "represent the most striking evidence of the decline in [tax] compliance" in our country today. The "outrageous shelters" that it reports about in its cover story are literally "tearing this country's tax system apart." It raises the question that more and more taxpayers are asking: "Am I a chump for paying what I owe?"

Here is basically what this bill seeks to do: First, it seeks to stop these schemes that have no "economic substance." That is, deals that are done not to achieve economic gain in a competitive marketplace or for other legitimate business reasons but to generate losses that offer a way to avoid the tax collector.

Second, it prevents tax cheats from buying the equivalent of a "get-out-of-jail-free" card to protect themselves in the unlikely event that they get caught. Some fancy legal opinion cannot be used as insurance against penalties for tax underpayments on transactions that have no economic substance.

Third, the bill increases and tightens penalties for tax dodging so that there is at least some downside risk to cheating.

Fourth, it requires the promoters and hustlers who market tax shelters to share a little of the penalty themselves with the offending taxpayer.

Fifth, it punishes the lawyers who write "penalty insurance" opinions that any reasonable person would know are unjustified.

Sixth, it penalizes those who fail to follow the disclosure rules. It recognizes that too often secrecy is the growth hormone for these complex tax-cheating shelter gimmicks.

Seventh, it expands the types of tax shelters that must be registered with the IRS, thereby facilitating tax enforcement.

Finally, it targets a few of what some might view as "attractive nuisances." That is, tax code provisions that are particularly subject to manipulation and misuse.

Battling these shelters one at a time, through years of costly litigation, has not prevented the steady growth in abusive practices. Indeed, the creativity and speed with which new and more complicated tax shelters are devised is remarkable. Following judicial and administrative rulings, tax shelters are repackaged and remarketed with creative titles like sequels to bad movies.

One type of gimmickery, called LILLO, has been used by an American company, which rents a Swiss town hall, not for any gathering, but only to rent it immediately back to the Swiss. The corporation takes a deduction from current taxable income for the total rental expense, while deferring income from its "re-rental" until far into the future. Within months of Treasury shutting down such abusive LILLO transactions, products were soon being sold as the "Son of LILLO," with only a modicum of difference from the previous version.

I have modified this legislation to take into account the comments that were raised at a November 1999 Committee on Ways and Means hearing. I have incorporated recommendations from the American Bar Association tax section, and bipartisan suggestions from leaders of the Senate Finance Committee last year. This bill has been carefully designed to curtail egregious behavior without impacting legitimate business deals.

Most of these refinements have had a very plain purpose: eliminate the excuse for inaction. This bill should now be acceptable to everyone but most blatant shelter hustlers. But that may not be the case.

Treasury Secretary Paul O'Neill recently gave an interview to a London newspaper in which he favored eliminating corporate taxation. If that is the ultimate objective, if he just waits a little while maintaining the same attitude of indifference in the face of rapidly proliferating shelter schemes it may eventually be accomplished. This will leave just a few "corporate chumps" paying anything close to their fair share.

Most taxpayers realize that if someone in the corporate towers or just down the street is not paying their fair share, you and I, and the others who play by the rules, must pay more to pick up the slack. And that slack, that loss of revenue to abusive tax shelters, is not estimated to exceed \$10 billion per year.

And that lost revenue could be put to better use. The bipartisan leaders of the managed care reform bill in the last Congress relied upon this proposal to offset any reduced federal revenues associated with adopting the Patients Bill of Rights. Although blocked procedurally, Representative CHARLIE NORWOOD (R-GA) got it right in telling the House Rules Committee, "There is a large difference in what you call a tax increase and stopping bogus tax shelters. That is really two different

things. They aren't just asking them to pay more taxes, we are trying to keep them from cheating the system."

Today, we sponsors of this legislation offer a constructive way of correcting abusive tax shelters, described by former Treasury Secretary Larry Summers as "the most serious compliance issue threatening the American tax system." Battling corporate tax cheats is not a partisan issue, it is a question of fundamental fairness. This Congress should promptly respond.

TECHNICAL EXPLANATION OF H.R. , THE
"ABUSIVE TAX SHELTER SHUTDOWN ACT OF
2001"

TITLE I—CLARIFICATION OF ECONOMIC SUBSTANCE DOCTRINE (SEC. 101)

PRESENT LAW

In general

The Internal Revenue Code ("Code") provides specific rules regarding the computation of taxable income, including the amount, timing, and character of items of income, gain, loss and deductions. These rules are designed to provide for the computation of taxable income in a manner that provides for a degree of specificity to both taxpayers and the government. Taxpayers generally may plan their transactions in reliance on these rules to determine the federal income tax consequences arising from the transactions.

Notwithstanding the presence of these rules for determining tax liability, the claimed tax results of a particular transaction may be challenged by the Secretary of the Treasury. For example, the Code grants the Secretary various authority to challenge tax results that would result in an abuse of these rules or the avoidance or evasion of tax (Secs. 269, 446, 482, 7701(1)). Further, the Secretary can challenge a tax result by applying the so-called "economic substance doctrine." This doctrine has been applied by the courts to deny unwarranted and unintended tax benefits in transactions whose undertaking does not result in a meaningful change to the taxpayer's economic position other than a purported reduction in federal income tax. Closely related doctrines also applied by the courts (sometimes interchangeable with the economic substance doctrine) include the so-called "sham transaction doctrine" and the "business purpose doctrine". (See, for example, *Knetsch v. United States*, 364 U.S. 361 (1960) denying interest deductions on a "sham transaction" whose only purpose was to create the deductions.) Also, the Secretary can argue that the substance of a transaction is different from the form in which the taxpayer has structured and reported the transaction and therefore, the taxpayer applied the improper rules to determine the tax consequences. Similarly, the Secretary may invoke the "step-transaction doctrine" to treat a series of formally separate "steps" as a single transaction if the steps are integrated, interdependent, and focused on a particular result.

Economic substance doctrine

The economic substance doctrine is a common law doctrine denying tax benefits in transactions which, apart from their claimed tax benefits, have little economic significance.

The seminal authority for the economic substance doctrine is the Supreme Court and Second Circuit decisions in *Gregory v. Helvering* (293 U.S. 465 (1935), *aff'd* 69 F.2d 809 (2d Cir. 1934)). In that case, a transitory subsidiary was used to effectuate a tax-advantaged distribution form a corporation. Notwithstanding that the transaction satisfied